IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 154 of 1989
with
INCOME TAX REFERENCE No 150 of 1989
with
INCOME TAX REFERENCE No 162 of 1989
with
INCOME TAX REFERENCE No 180 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE M.S.SHAH
and
Hon'ble MR.JUSTICE K.A.PUJ

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME TAX
Versus
SHRI NATVARLAL V. DESAI

Appearance:
MR TANVISH U BHATT for Petitioner No. 1
SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE M.S.SHAH
and
MR.JUSTICE K.A.PUJ

Date of decision: 05/07/2002

COMMON ORAL JUDGEMENT

(Per : MR.JUSTICE K.A.PUJ)

In all, these four references were filed by the revenue and they are pertaining to different assessment year. Income-tax Reference No. 154 of 1989 is in respect of assessment year 1976-77, Income-tax Reference No. 150 of 1989 is in respect of assessment year 1978-79, Income-tax Reference No. 162 of 1989 is in respect of assessment year 1981-82, and Income-tax Reference No. 180 of 1988 is in respect of assessment years 1982-83 and 1983-84. Since common issue is involved in all the four reference, they are disposed of by this common judgment.

2. At the instance of the revenue, the following question of law is referred to for the opinion of this Court :-

"Whether, on the facts and in the circumstances of the case, the finding of the Appellate Tribunal that no sub-partnership was formed between the assessee and his wife Smt. Suryakanta Natwarlal and the share of the assessee's wife could not be included in the income of the assessee, is correct in law and sustainable from the material on record ?"

Although there is slight variation in framing of the question for the subsequent years, but the controversy raised is same in all the four assessment years and hence considering the question raised and referred to in Income-tax Reference No. 154 of 1989 and the facts stated therein, we incline to give our answer to the said question as under.

3. The assessee was the karta of an HUF consisting of himself, his wife Mrs Suryakanta and their son Pradip. This HUF was a partner in a firm N. Desai & Co. represented by the assessee karta. The capital invested by the HUF in the firm was Rs.15,000/- and its share in that firm was 75%. There was a partial partition of the HUF on 30.6.1971 by a deed of partition. The said amount of Rs.15,000/- was divided equally between the assessee and his wife and their son. However, so far as the share amounting to 75% was concerned, son Pradip was given 1/3rd i.e. 25% with a right to become a partner in the said firm. Regarding the balance of 50%, the assessee was given "right to become a partner in the said firm with 50% share therein as for his share on this partition, subject to 1/2 of the income i.e. 25% share of income of the firm of N. Desai & Co. being payable

to Mrs Suryakanta, the party hereto of the second part at the end of every Samvat Year, the result being that 1.2 of 50% that is 25% share in income of the firm of N. Desai & Co.; remaining with him, and the other 25% being the income to be handed being that each of the parties hereto gets 25% share of income as for his or her share on this partition ... ..." (The above quotation is from the partition deed itself). The partition deed also provides that Mrs Suryakanta "shall have prior charge over his share of income in the firm of N. Desai & Co. to the extent indicated hereinabove."

4. On 1.7.1971 a new partnership deed was executed so that in the firm N. Desai & Co. the assessee had new 50% share and his son Pradip had 25% share therein. The Income-tax Officer held that with regard to the 50% share of the assessee in the said firm, there came into existence a sub-partnership between the assessee and his wife and therefore added the share income of the wife to the income of the assessee. He relied upon the decision of this Court in the case of CIT vs. Mahendrasingh Mohansingh, (1980) 123 ITR 938 (Guj.). He also relied upon the observations of the Tribunal in the assessee's own case for the assessment years 1972-73 to 1974-75 that the second transaction partook the character of sub-partnership. By the second transaction, the Tribunal was referring to the deed of partition. However, the Tribunal ultimately directed the Income-tax Officer to decide the matter in the light of the said decision in the case of Mahendrasingh (Supra). The CIT(A) allowed appeal filed by the assessee.

5. Being aggrieved by the order of the Commissioner of Income-tax (Appeals), the revenue has preferred an appeal before the Tribunal and the Tribunal has considered its earlier order in the assessee's own case for the assessment years 1972-73 to 1974-75 and has also dealt with the judgment in the case of CIT vs. Mahendrasingh Mohansingh, (1980) 123 ITR 938 (Guj.) and after distinguishing the facts of the assessee's case with the facts of that case, the Tribunal has come to the conclusion that "the case of Mahendrasingh (supra) was quite different. In that case, pursuant to the partition an agreement was effected between the assessee and his wife and their son, agreeing that the assessee be allowed to use the sums received by the son and wife on partition so as to continue to remain as partner in the firm representing them. In consideration thereof, the assessee, inter alia, was to share equally the profits from that firm. Thus in that case, there was a separate agreement with his wife and son and there was

consideration also for that agreement. It was for these reasons that the Court held that there was a sub-partnership in that case. Therefore, the ratio of that case is that there has to be a clear agreement satisfying all the requirements of partnership. In the present case, that is not so. The revenue's case is based merely on an inference. None of the requirements of partnership stated above are satisfied. Therefore, we hold that there is no sub-partnership in the case and we confirm the orders of the CIT (Appeals)".

Being aggrieved by the aforesaid decision of the Tribunal, the revenue has come in reference before this Court on the above referred question.

6. We have heard Mr Tanvish Bhatt, learned standing counsel appearing for the revenue. Nobody appears on behalf of the respondent-assessee though the notice was duly served.

7. Mr Tanvish Bhatt has vehemently urged before us that the case of the assessee is squarely covered by the decision of this Court in CIT vs Mahendrasingh Mohansingh (Supra). In that case, the assessee was a partner in a firm in his capacity as karta of his HUF consisting of himself, his wife and their minor son. A partial partition was effected amongst the members of the HUF on 2.11.1967 whereby it was decided to partition the amount of capital invested by the HUF in the firm and also its interest therein. The amount standing in the books of the firm to the credit of the HUF was Rs.55,049-55, which was divided into three equal shares among the assessee, his wife and son and each of them became the separate owner of a separate one-third share, namely, Rs.18,348-86. Pursuant to the partition, an agreement was effected between the assessee, his wife and their son on 7.12.1967, agreeing that the assessee should be allowed and permitted by his wife and son to use the aforesaid amounts representing one-third share each belonging to wife and son of the assessee, and the assessee could, on and form 3.11.1967, continue as a partner in the firm for himself and as representative of his wife and son. In consideration of the use of these amounts, the assessee agreed to share equally with his wife and son the profits coming to his share from the firm, subject, however, to the obligation of making to each of them a minimum payment of Rs.1,000 per annum. On these facts, the question that arose before the Court was whether the wife and minor son became partners in the firm, or, in the alternative, a sub-partnership came into existence between them and the assessee. On these facts,

this Court has held that (i) the wife and minor son of the assessee did not become partners in the firm; (ii) however, there was a sub-partnership between the assessee, his wife and their son because all the three elements necessary to constitute a partnership were present. The assessee, his wife and his minor son agreed to share the profits earned by the assessee; and the assessee continued to act as a partner not only on behalf of himself but also on behalf of his wife and minor son in the main firm. The agreement was merely for sharing of profits coming to the assessee from the main firm and, therefore, the minor son of the assessee could never be held liable for the losses of that sub-partnership, if at all losses arose in the business of sub-partnership. Therefore, a sub-partnership consisting of the assessee, his wife and son had come into existence on the partial partition by virtue of the agreement of 7.12.1967; (iii) the shares of the assessee's wife and son were liable to be included in the total income of the assessee under Section 64 of the Income-tax Act, 1961.

All these facts and the ratio laid down by this Court were pressed into service by Mr Tanvish Bhatt and contended that all the three conditions laid down in the aforesaid decision were present in the present case and hence this is also a case of sub-partnership and the share of the assessee's wife is required to be included in the assessment of the assessee.

8. Mr Bhatt has further drawn our attention to the decision of the Punjab & Haryana High Court in the case of CIT vs. Narinder Kumar, (1989_) 177 ITR 515. In that judgment, the Punjab & Haryana High Court has referred to three other judgments including the judgment of this Court in CIT vs. Mahendrasingh Mohansingh, (1980) 123 ITR 938, CIT vs. Ram Narain, (1980) 126 ITR 267 (P&H) and CIT vs. Pabbati Shankaraiah, (1984) 145 ITR 702 (AP). While distinguishing the judgment of this Court on facts and agreeing to its earlier decision in Ram Narain's case (Supra), the Punjab & Haryana High Court has held that there was a clause creating an overriding obligation on the karta to make over the income of the other members of the family with whom a partial partition had been effected and it was held that the share of each such member from the inception accrued to them, creating thereby a superior right in their favour and was thus not assessable in the hands of the father who was the karta. The Court has also referred to the decision in Pabbati Shankaraiah's case (Supra) and observed that the matter has been considered threadbare and agreeing with the view taken therein, it was held that the Tribunal was right in

holding that no sub-partnership consisting of the assessee, his wife and son came into existence on the partial partition, which was effected by a partial partition deed dated 31.3.1973 and thus the shares of the wife and the son received from the two partnership firms, were rightly not included in the income of the assessee under Section 64 of the Act.

9. The above discussion shows that the important point of the distinction between the facts of the Mahendrasingh's case and the facts of the present case and which is rightly carved out by the Tribunal after considering the partition deed is that actually the assessee's right to receive 50% share from the firm N. Desai & Co. was subject to 1/2 of it being given to his wife and that the wife had a prior charge over the share income received from that firm. The Tribunal has, therefore, come to the conclusion that this was not a case of sharing the profits of a partnership between the assessee and his wife but of subjecting the assessee's share from the firm of N. Desai & Co. to 50% charge by the wife. It is not as if the assessee and his wife are jointly doing some business and after the profits are received from that business, they are dividing it between themselves. It was also found by the Tribunal that the assessee was not carrying on the business for himself and his wife and that the assessee is merely a partner in the firm N. Desai & Co. having a right to get 50% share of the profits. That 50% share was subject to the charge of his wife to the extent of 1/2 of it. That was merely a division of the profit and not authority to carry on business on behalf of the wife. Therefore, the requirement of partnership as laid down by this Court in Mahendrasingh's case is not satisfied in present case. It was further observed that the intention was to secure to the wife her one-third share of the profits from the firm N. Desai & Co., and for that she was not to become a partner in the firm N. Desai & Co. and if that was the intention, she could have been made a partner as clearly as the son had been made a partner in the firm N. Desai & Co.; her one-third share of the capital could be given to her separately and that has, in fact, been done. As far as the one-third share in the firm N. Desai & Co. was concerned, the only way in which this could be done was to give her an overriding charge on the profit received by the karta husband. Therefore, actually this is a case of diversion of the profit at source and the assessee's wife has agreed to make a partition as the recital in the partition deed states and not to any other transaction. Therefore, the partnership is not to be inferred. Such inference would certainly go against the

expressed intention of the parties.

10. Even before us, noting was pointed out to us which would show that the requirements of the partnership as stated above were satisfied in the present case. Simply on the basis of the inference drawn by the revenue, it cannot be said that sub-partnership was created. We, therefore, agree with the reasonings given by the Tribunal and hold that no sub-partnership was formed between the assessee and his wife and the share of the assessee's wife could not be included in the income of the assessee.

11. We, therefore, answer the question in the affirmative i.e. in favour of the assessee and against the revenue. The answers to other three references are also in favour of the assessee and against the revenue.

All the four references are accordingly disposed of with no order as to costs.

(M.S. Shah, J.) (K.A. Puj, J.)

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